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RUEHPF/AMEMBASSY PHNOM PENH 0100
RUEHCG/AMCONSUL CHENNAI 9812
RUEHKP/AMCONSUL KARACHI 2634
RUEHCI/AMCONSUL KOLKATA 0494
RUEHLH/AMCONSUL LAHORE 0120
RUEHBI/AMCONSUL MUMBAI 7101
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SUBJECT: ECONOMIC DIFFICULTIES IN SRI LANKA'S CENTRAL PROVINCE

REF: COLOMBO 02

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¶1. SUMMARY: Sri Lanka's mountainous Central Province includes the country's second largest city, the majority of the tea-planting region, and a sizeable number of foreign investment and export-oriented industries. Unfortunately the province's economy is struggling under the weight of the global economic downturn, the high cost of borrowing money, a reduction in foreign investment, and the government's development focus on the war-torn North and East. Business people and Chamber of Commerce contacts emphasized their hopes that the economy will be the prime focus in the upcoming Presidential election (reftel) and that an economic "peace dividend" will eventually benefit the region. END SUMMARY.

¶2. Kandy, Sri Lanka's historic capital, is the country's second largest city and is the capital of the Central Province, a region which takes in much of the hill country (rising to 6000 feet) with its verdant tea plantations, vegetable farms, and country villages. The Central Province (CP) covers nearly 2200 square miles and has a population of 2.6 million people. Its 2008 GDP was \$4.0 billion and its per capita income was \$1535/year -- slightly below the national average of \$2014/year. The CP produces shoes, baked goods, furniture, and vegetables for local consumption; and tea and some textiles for foreign markets. Tourism is also an important driver of economic activity.

¶3. Unfortunately, the economic situation in the region has slowly deteriorated over the past five years. After a spurt of central government interest and directed investment which began 15 years ago, the government's focus slowly shifted first toward winning the war against the Tamil Tigers and more recently on rebuilding the affected northern and eastern regions of the country. In the past year, the global financial crisis has also taken its toll, particularly on the export-oriented textile industries located in the province. According to one textile producer, nearly 50 percent of the CP's moderate number of textile companies closed their doors in the past year, and others dramatically reduced their number of employees (also likely to be compounded should the EU's GSP-Plus tariff-reduction benefit for textiles end this

summer). And while tea prices are fetching record prices, the value of those sales is registered in the Western Province where Colombo's tea auctions occur and therefore is not reflected as part of the CP's economic activities. The actual plantations, on the other hand, suffer with some of the country's highest levels of poverty, further dragging down the Province's per capita income.

¶4. The biggest complaint heard, however, was the lack of monetary circulation and difficulty in obtaining a bank loan for a reasonable interest rate. (NOTE: This is an island-wide complaint. END NOTE.) Loan rates are often as high as 20 percent and even state-run banks (which were recently forced to lower rates below market) employ various means to deny those lower rates to your average small business owner. Mr. Anuruddha Warnakula, President of the Central Province Chamber of Commerce, also noted a decided lack of confidence in the central government's economic policy. He noted how new taxes have hindered growth and lamented the fact that the government ended its support in 2006 for the successful business incubator located outside Kandy. The Board of Investment's targeted tax exemption for the region (begun in 1994) was ended under the Rajapaksa administration in 2004, leading to further stagnation. Warnakula also described the central government's Export Development Board field office in Kandy as "useless" and lamented the decided lack of entrepreneurship in the region.

¶5. COMMENT: While both candidates for January's presidential election are talking about economic issues, neither candidate has developed a clear and believable economic platform to improve the CP's situation. While the prospects of rapid peace-time development in the CP remain unclear --

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particularly if the North and East continue to receive the bulk of national and international investment and development assistance -- the fundamentals for the province remain good. Labor costs are low, transportation times to the port are quick, and tourism growth continues. As the global recession ends, the CP's economy should once again expand as a peaceful Sri Lanka finally focuses on issues other than the war. END COMMENT.
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